

MINUTES

**MONTANA SENATE
56th LEGISLATURE - REGULAR SESSION**

COMMITTEE ON TAXATION

Call to Order: By **VICE-CHAIRMAN BOB DEPRATU**, on March 23, 1999
at 8:00 A.M., in Room 413/415 Capitol.

ROLL CALL

Members Present:

Sen. Gerry Devlin, Chairman (R)
Sen. Bob DePratu, Vice Chairman (R)
Sen. John C. Bohlinger (R)
Sen. Dorothy Eck (D)
Sen. E. P. "Pete" Ekegren (R)
Sen. Jon Ellingson (D)
Sen. Alvin Ellis Jr. (R)
Sen. Bill Glaser (R)
Sen. Barry "Spook" Stang (D)

Members Excused: None

Members Absent: None

Staff Present: Sandy Barnes, Committee Secretary
Lee Heiman, Legislative Branch

Please Note: These are summary minutes. Testimony and
discussion are paraphrased and condensed.

Committee Business Summary:

Hearing(s) & Date(s) Posted: SB 533, 3/19/1999
Executive Action: SB 533

HEARING ON SB 533

Sponsor: SENATOR GERRY DEVLIN, SD2, TERRY

Proponents: Mike Parker, Pennington's
Chris Tweeten, Attorney General's Office
Mark Staples, Montana Wholesalers Association
Jerome Anderson, Brown & Williamson Tobacco Company
Jeff Miller, Department of Revenue

Steve Wade, Phillip-Morris

Opponents: None

Opening Statement by Sponsor:

SEN. GERRY DEVLIN, SD 2, TERRY, said that the reasoning behind **SB 533** is that since the price of cigarettes have gotten so expensive, there have been some activities taking place to circumvent the importation of cigarettes. **SB 533** is patterned after a Colorado law which prohibits cigarettes destined for foreign countries coming back into this country for sale.

Proponents' Testimony:

Mike Parker, Pennington's, said that **SB 533** prohibits importation into the state of Montana any cigarettes that contradict federal law with respect to packaging, content or intended consumption outside the United States. He said that in response to price increases in cigarette costs, there has been a huge increase in "gray market" activity. He said it is called "gray market" rather than "black market" because typically the federal tax is paid at the port. These cigarettes are then returned to the country and shipped to sellers. Cigarettes for export are sold at lower cost than domestic sales in order to be competitive with government subsidized enterprises throughout the world. He said these cigarettes can be sold for \$5 to \$10 a carton less.

Mr. Parker said that the risk to the state of Montana is that the payments in the recent tobacco settlement are based on domestic shipments by manufacturers to the legitimately taxed trade, so for every carton of cigarettes that comes through the gray market, even if the state taxes are eventually paid, there is a potential loss of \$1.80 a carton initially in the first year of the settlement payments, going to as much as \$3.50 per carton in 2005.

Mr. Parker said that the second problem comes with the attempt to limit youth access to tobacco products. He said part of the rise in prices for tobacco products was to make it punitive to smoke, and youth, in particular, would be pinched by those higher prices. This drops the price down significantly. He encouraged passage of **SB 533**.

Chris Tweeten, Chief Counsel, Montana Department of Justice, on behalf of Attorney General Joe Mazurek, said the Attorney General encourages passage of **SB 533** for all of the reasons expressed by **Mr. Parker**. However, he would like to suggest one minor amendment to the bill. He said on page 2, the bill purports to

allow the Department of Revenue to institute criminal prosecution with respect to violations of this act. Criminal prosecutions are ordinarily instituted by county attorneys in Montana. He said even the Attorney General has only limited authority to institute criminal prosecutions in district or justice courts. He suggested that criminal violations of this statute should be treated in the same way as others are that are detected by agents of the state of Montana, and that is to be referred to county attorneys for prosecution.

Mark Staples, Montana Wholesalers Association, said the members of his organization wholeheartedly concur in this bill.

Jerome Anderson, Brown & Williamson Tobacco Company, said they support this bill. He said a month ago in the Wall Street Journal there was an article about the gray market of cigarettes which contained pictures of cigarettes to be marketed in the United States and those for consumption outside the United States. He said side-by-side a difference is obvious, but one without the other, it is very difficult to tell.

Jeff Miller, Department of Revenue, said his Department supports this bill for all the reasons already indicated. He said it would make explicitly illegal the importation of these cigarettes, and the Department feels that is an additional clarification and awareness kind of issue for people marketing cigarettes in the United States.

Steve Wade, Phillip-Morris, said Phillip-Morris goes on record in support of **SB 533**. They feel it is a good idea and ask that it be passed out of committee.

Opponents' Testimony: None

Questions from Committee Members and Responses:

SEN. ELLIS said that the Department of Revenue normally prosecutes violations of tax law, but this law violates the importation of non-taxed items, and he wondered how the Department of Revenue perceived the Department of Justice suggestion for an amendment. **Mr. Miller** said the suggestion to take the Department of Revenue out of the criminal loop is probably a good suggestion. He said the Department pursues civil penalties, but they do not typically prosecute criminal cases.

SEN. EKEGREN asked if the Montana tax was paid on these gray market cigarettes somehow, whether that activity is still illegal to bring cigarettes into Montana that were designed to be shipped out of the country. **Mr. Miller** said that as the Department reads

the bill, that is exactly the activity that would be prohibited. He said even if the Montana tax were paid on these cigarettes, they are still illegal in the U.S. and should not be sold here.

SEN. EKEGREN asked if the burden of this bill is on the consumer, and **Mr. Miller** said that the burden of the cigarette tax is intended to pass to the consumer, so the consumption of unstamped cigarettes in Montana is illegal, and the infraction is on the consumer.

SEN. BOHLINGER said that **Mr. Anderson** had mentioned an article in the Wall Street Journal, and he wondered what the visible difference was between the two packs of cigarettes. **Mr. Anderson** said that the color on the packages was the same, the naming was slightly different on the two, and there was no warning label on the side of the illegal package. He said the differences are obvious when two packages are side by side, but seeing them individually, the differences may not be as easily observed.

SEN. BOHLINGER then asked if **Mr. Staples** could elaborate on that issue, and **Mr. Staples** said that he wanted to address the issue of if the federal tax is affixed and the state tax is affixed, why we care if these cigarettes come into the country. He said the cigarettes are sold when they go out to sea, and they are sold for \$5 to \$6 less per carton than they are in the United States. So when they come back, even though they have the same taxes, they are still significantly priced differently because they just did this little turnaround. He said it is not necessarily just the absence or presence of tax, it is this little pricing loop that takes place.

SEN. BOHLINGER asked, then, if all states should be concerned about the sale of illegal cigarettes and the price advantage they might provide some unlawful vendor. He wondered if all states should request of tobacco manufacturers that they package these cigarettes a little differently to make them more identifiable.

Mr. Staples said all states are concerned and they are rapidly passing these laws. He said the federal government is also concerned, and the FTC has passed a law as of January 2000. Finally, he said there is a little difference in packaging, but that that is an ongoing concern that has not been resolved.

SEN. ECK said if it was possible to get the federal stamps and the state stamps, how are they marketed to the retailer. **Mr. Parker** said that as a wholesaler, they have offers frequently to buy gray market cigarettes. Those cigarettes, if purchased, would be taken into the warehouse and stamped, and then they would be sold. The risk for the state is that portion of the tobacco settlement agreement that pays the state \$800 million over the next 25 years. **Mr. Parker** said these cigarettes are frequently sold out of someone's trunk, door to door, or to their

neighbors and friends, and they escape taxation because they don't go through a warehouse. **Mr. Parker** said in addition, the \$1.80 state tax is also not paid.

SEN. ECK asked if that meant that someone who buys cigarettes from the internet, when they are received, they would not have the state tax on them, and **Mr. Parker** said that was correct.

SEN. ECK said that they would then be selling cigarettes out of the back of their car without a state tax which would mean that the individual who bought them would also be liable, as well as the person who sold them. **Mr. Parker** said that was correct. He said he feels that the primary concern of the state is the possibility that the state will lose a portion of that settlement because those payments will be based on domestic shipments of the manufacturers only, and will not take into account the cigarettes that are going through the gray market. It is estimated that as much as 5% of all the cigarettes in the United States currently are gray market cigarettes intended for export.

SEN. ECK asked about sales through the internet, and she wondered if some of these were sold directly to the consumer and don't go through a wholesaler. **Mr. Parker** said there was some of that, but most of the significant movement of the product through gray market is by container loads so that they are packed at the manufacturer in truck-body sized containers for export.

SEN. GLASER asked if this could be into Mexico or Canada and back, and **Mr. Parker** said that there was some traffic coming across the Canadian border. He said that the manufacturers sell into the export market for \$5 or \$6 a carton less than they sell into the domestic market, and they do that to compete with the government subsidized manufacturer in foreign countries. So those cigarettes begin their life with the \$6-a-carton advantage, and that is what inspired this routing back into the United States.

SEN. ELLINGSON asked if there was any financial advantage to the manufacturers to re-import these for-export cigarettes, and **Mr. Parker** said the manufacturers contend there is not, and they back that up with lawsuits against persons and organizations engaged in that gray market trade in the U.S.

SEN. ELLINGSON said that during the discussion of whether to bring this out as a committee bill, **SEN. ELLIS** had raised a question about comparing this to other illegal drugs, and he wondered what the profit potential is from one of these transactions. **Mr. Parker** said that a 40-foot trailer would contain approximately 48,000 cartons at \$5, and if one could

transact 10 containers a month, that would be a pretty good living.

SEN. ELLIS said he thought the difference in price was the monies that the cigarette companies had obligated to the lawsuit and therefore domestic prices had to be higher, and **Mr. Parker** said they were \$5 to \$6 cheaper off-shore because of competition.

SEN. ELLIS wondered where the money came from for the lawsuit, and **Mr. Parker** said cigarette companies and wholesalers and retailers just recently raised cigarette prices, and the payments for the Attorney Generals' settlement will come from that price increase.

SEN. STANG asked, then, if cigarettes were sold for \$5 or \$6 a carton less off-shore, does that mean that now, after the lawsuit, those cigarettes are being sold for \$12 a carton less, and **Mr. Parker** said that prior to the settlement, there was a \$5 or \$6 differential and there was a good bit of gray market activity, but with this recent price increase, it has gone up tremendously. **SEN. STANG** asked how long United States smokers have been subsidizing out-of-country smokers, and **Mr. Parker** said he had no way of knowing.

SEN. DEPRATU asked if a retail establishment that would normally sell cigarettes wanted to get gray market cigarettes, would they have to go outside of the normal channels for wholesale purchases, and **Mr. Parker** said that the packages are clearly marked "Not Intended for Domestic Consumption." If they came to a retailer with a tax stamp, they would have to come through a wholesaler. If they didn't have tax stamps, they could have come from anywhere.

Closing by Sponsor:

SEN. DEVLIN said he still had a question about someone who might buy a pack of cigarettes in Canada, and whether he would be detained at the border for a pack in his pocket. He said if this bill goes that far, it will not have his support. He did say, though, that it is an area that probably needs a piece of legislation. He suggested that if the committee members had some questions, they should talk to some of the proponents.

EXECUTIVE ACTION ON SB 533

SEN. DEVLIN said that perhaps the committee could take some action on **SB 533** and move it out of committee. He said he believes there is reason to pass this legislation. Perhaps it has not been happening much in Montana as yet, but since we are next to a border, it really has the potential.

SEN. DEPRATU asked about **SEN. DEVLIN'S** remark about a pack of cigarettes purchased in Canada, and **Mr. Heiman** indicated that there is an exemption to get it across the border.

CHAIRMAN DEVLIN said that **Mr. Tweeten** had suggested that if a section from page 2, line 1, "either through criminal prosecution or," were eliminated, that would put that back on the county attorneys. The language would then say that "the Department may proceed against a person who violates this section through a civil action under the civil enforcement provisions of Title 16, chapter 10, part 4."

SEN. ELLINGSON asked then if this eliminates the possibility of criminal prosecution, and **Mr. Heiman** said that subsection (b) covers that.

Motion/Vote: **SEN. STANG MOVED AN AMENDMENT STRIKING "EITHER THROUGH CRIMINAL PROSECUTION OR" FROM PAGE 2, LINE 1 OF THE BILL.**
Motion carried 9-0.

Motion/Vote: **SEN. STANG MOVED THAT SB 533 DO PASS AS AMENDED.**
Motion carried 9-0.

DISCUSSION ON SB 529

SEN. STANG said there has been some question as to whether a Constitutional amendment could be kept in committee, and he thought he might make a motion to reconsider the action on **SB 529** to perhaps keep the discussion on the floor to the contents of the bill instead of to the fact that a Constitutional amendment was tied up in committee.

Motion: **SEN. STANG MOVED TO RECONSIDER THE COMMITTEE'S ACTION ON SB 529.**

Discussion:

CHAIRMAN DEVLIN said he had done some research because there was a question that because it was a Constitutional amendment that the committee could not table it, but he had found that indeed a committee can, according to Mason's. According to Mason's, it is just like any other question in the committee, and it takes the same vote to take it from this committee to the floor as any other piece of legislation. The motion, however, is to reconsider the committee's action of tabling **SB 529**.

SEN. ELLINGSON asked if it had been considered what might happen if on the floor of the Senate a motion was made to take it from

this committee and the Senate votes on it, then there is a part of the rules that says that any vote in the Senate on a Constitutional amendment where there is still the mathematical possibility has to result in referring it on to the House. Even if there is only one vote, it would still go on to the House. He said he thinks that the motion could then be made on the floor to debate it; and even if it goes down, it has to come out in effect so that it can go to the House, and he wondered if that had been discussed. **Mr. Heiman** said that the vote on the bill is the third reading vote, so a vote on a motion to take it from the committee is not a vote on the bill. It is a vote on a motion to take it from this table. He said the section is 491 of Mason's, Section 5.

SEN. STANG then asked if it is the third reading vote that moves it to the House, and if a Constitutional amendment fails to get enough votes on second reading, why is it moved to third reading. **Mr. Heiman** said that because there has already been a vote, it is the number of votes on the third reading that is the number of votes that determines the mathematical possibility. **SEN. STANG** said that that was not the question. He said that if a motion has failed on the floor, it would not be able to move forward; but if a bill that is a Constitutional amendment fails second reading, it moves forward, and he wondered what the difference was. **CHAIRMAN DEVLIN** said the motion is to take it from a committee, and this section refers to a committee, and a motion to move it from a committee to take it to the floor takes a majority vote.

SEN. ECK said that she feels that eventually this whole issue is going to require a Supreme Court decision because the Constitution does say there must be a vote on every bill. She said that when the process of tabling bills was started, there was a good bit of discussion of the legality of that. It used to be that every bill was reported out with a "Do Pass" or a "Do Not Pass," and she feels that that requirement is being circumvented by not doing that. She said in this case she would rather send the bill out with a "Do Not Pass" from the committee, because otherwise the procedural process is being hurt.

SEN. GLASER said that if this motion is successful and if this bill goes to the floor, or if this motion is successful and it comes before this committee to be debated again, he wondered if it would be appropriate for him to place his proposed amendment on the bill, or would it be proper to put it on on the floor. **CHAIRMAN DEVLIN** said that would be his choice, but it would be amendable if this motion passes, and then there would be another motion to probably do pass, and at that time motions to amend are in order.

SEN. STANG said that the reason he brought this up is because the Great Falls paper had a story about the school board in Great Falls. They had canceled one school election because there was nobody else running and that saved them some money, but they have put off their last election so they could wait and see what the legislature did in regard to education funding. They did not want to vote without knowing what would happen to their local taxpayers. With a Constitutional amendment like this on the books, it would give those people an idea that if something is passed here, they know that it will be backfilled, and they won't be out there in limbo waiting until the legislature is done.

CHAIRMAN DEVLIN said there is another piece of legislation that says about the same thing as this Constitutional amendment, but is legislatively done.

Vote: Motion failed 3-6 with Devlin, Bohlinger, Ekegren, Ellis, Glaser and Depratu voting no (Roll call vote #1).

ADJOURNMENT

Adjournment: 9:00 A.M.

SEN. GERRY DEVLIN, Chairman

SANDY BARNES, Secretary

GD/SB

EXHIBIT (tas65aad)